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C O N F I D E N T I A L SECTION 01 OF 02 YEREVAN 000459

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SUBJECT: HARD TIMES FOR AGRC LEAVES OTHER INVESTORS WORRIED

REF: 06 TASHKENT 1356

Classified By: Econ Officer E. Pelletreau for reasons 1.4 (b,d).

SUMMARY

¶1. (C) The Armenian Gold Recovery Company (AGRC), plagued by allegations of tax evasion and failure to report profits, appears to be the latest casualty of rising gold prices and a possible Russian push to increase economic ties with Armenia.

After a difficult confrontation with the Ministry of Nature Protection in 2004 and 2005, AGRC management had believed that its position in Armenia was secure following a September 2006 meeting between AGRC owner Anil Agarwal and President Kocharian. Despite announcing plans to invest USD 100 million in Armenia, it now appears, however, that AGRC is being forced out. While the GOAM is publicly accusing the company of tax evasion and underreporting of real production volumes, the CEO of AGRC contends that the GOAM's actions are purely politically motivated and are designed to open up new opportunities for Russia to invest in the Armenian mining sector. END SUMMARY.

THE AGARWAL CLAN: AGRC, STERILITE GOLD AND VEDANTA

¶2. (SBU) AGRC was the largest foreign investor in Armenia in when it entered the market in 1999 and remains the only real employer in one of Armenia's most impoverished, north-eastern provinces. AGRC is 100% owned by Sterilite Gold (a Canadian company) which is in turn 83% owned by Vedanta Resources (owned by Indian mining magnate Anil Agarwal and listed on the London stock exchange). In 2002, AGRC acquired full ownership of two gold mines in Armenia (Zod and Meghrazdor) and a processing plant in Ararat. In early 2004, AGRC proposed building a new processing plant closer to the Zod mine. The proposal was turned down by the Minister of Nature Protection on the grounds that it posed an unacceptable environmental threat to near-by Lake Sevan. Around the same time, the notoriously corrupt Minister announced that AGRC was guilty of tax evasion and failure to report profits. The dispute was coming to a head when Vedanta Resources Chairman Anil Agarwal met with President Kocharian in September 2006. Following that meeting, Agarwal unveiled AGRC's new USD 100 million investment plan for Armenia which included upgrading and remodeling of the Ararat processing plant, purchasing heavy mining equipment and mitigating the environmental impact of both plant and mine operations.

A DEAL GONE BAD

13. (C) According to AGRC's local CEO B.K. Sharma, the investment plan was part of a verbal agreement between Kocharian and Agarwal. When AGRC received the draft written agreement, however, it included a number of undisclosed and unacceptable terms including a pledge of 100% of AGRC's shares to the GOAM, a provision granting the GOAM an absolute and unilateral right to cancel AGRC's licenses, a requirement that AGRC forego the right to international arbitration granted in its 2002 contract with the GOAM, and a requirement that AGRC forego the right to sell its assets within Armenia. Furthermore, in the original 2002 agreement, the GOAM had agreed to cover the cost of transporting raw ore from the Zod mine to the processing plant in Ararat. The proposed new agreement contained no mention of transportation costs.

14. (C) AGRC found the new proposal to be unacceptable and sent a counter offer to the President in December 2006. Rather than negotiating, the President appears to have opted for a more aggressive approach. In January 2007, AGRC was notified that it was under investigation by the Armenian Prosecutor General. According to Sharma, President Kocharian ordered the Prosecutor General to reopen the 2005 investigations related to AGRC's alleged tax evasion and failure to report profits. Sharma told us he was personally threatened by staff at the Prosecutor General's office and had been told that if the company did not sell its assets all company staff would be arrested and the company's assets would be confiscated.

AGRC TRIES (TOO LATE) TO RALLY THE TROOPS

YEREVAN 00000459 002 OF 002

15. (C) In February 2007, the Prosecutor General froze AGRC's bank accounts without notice and AGRC was forced to halt operations. AGRC tried to rally the business and diplomatic community to its aid in February and March, making appeals to the Indian, British, German and American Embassies and the American Chamber of Commerce. (NOTE: The tie to Germany and the U.S. was that AGRC recently contracted to buy millions of dollars worth of Caterpillar equipment from a German distributor. END NOTE.) AGRC's efforts, however, proved to be too little too late. When the heads of the respective diplomatic missions made a joint inquiry at the Presidency, they were essentially stonewalled. President Kocharian's Chief of Staff stated bluntly that Agarwal had reneged on the verbal agreement made in September 2006 and that the President's office would no longer intervene in the case. AGRC's Indian-national miners and engineers have now left the country and it appears that AGRC is making every effort to close out its operation in Armenia on the best terms possible.

THE RUSSIANS?

16. (C) While we are not aware of any specific offers for the company's Armenian assets, AGRC is certain that they are being forced out to leave the door open for an unspecified Russian investor. Sharma provided us with press articles quoting Kocharian saying Russia will become Armenia's number one foreign investor and suggesting that Russia was particularly focused on the mining industry. He personally is convinced that the Russians and Armenians have already struck a deal in regards to AGRC's two mines and that once AGRC leaves, Russia will pick up the mines on the cheap.

COMMENT:

17. (SBU) Throughout the FSU, the near doubling of gold prices in the past five years appears to have left many governments dissatisfied with the deals they struck with foreign investors in the early years of independence (reftel). AGRC has a poor reputation in Armenia as an exploitative company that does not protect workers' rights. Vedanta and Anil Agarwal also have a poor reputation internationally and it is plausible that AGRC may have been involved in tax evasion and underreporting profits. The way in which the company is being forced out of the Armenian market, however, is causing concern throughout the business community. The fact that the company was not given any notice before its bank accounts were closed, the personal threats against company management, and the likelihood that AGRC will have minimal success in liquidating its Armenian assets leaves other foreign investors, in the mining sector and beyond, wondering how safe their businesses are in the face of Armenia's ever changing political winds.

GODFREY